

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

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FISCAL IMPACT STATEMENT

LS 6272

BILL NUMBER: HB 1840

DATE PREPARED: Nov 17, 1998

BILL AMENDED:

SUBJECT: Local Property Tax Replacement Income Tax.

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FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill allows a county council to impose a Property Tax Replacement Income Tax (PRIT) not exceeding 1% for the county. It allows the county council to use revenues from PRIT for property tax replacement credit.

The bill also provides an additional state distribution to local units in an adopting county in the amount of 20% of the PRIT imposed by the county. It allows the additional distribution to be used for local road and street funding.

Effective Date: Upon passage; January 1, 2000.

Explanation of State Expenditures: See Local Revenues section below for a detailed explanation of this bill and how it impacts the State Property Tax Replacement Fund.

Administrative Impacts: There will be some costs to the Department of Revenue (DOR) for the administration, audit and collection of taxes. The State Budget Agency will be required to determine the annual certified distributions of the Property Tax Replacement Income Tax (PRIT) revenues for all adopting counties. The Board of Tax Commissioners will be expected to determine the distribution of county PRIT revenues to all the civil taxing units within the adopting county. These responsibilities may require additional resources depending on how many counties choose to adopt PRIT and at what rate. The departments listed above all receive state General Fund money for their operating expenditures.

Explanation of State Revenues:

Explanation of Local Expenditures: Local expenditures for the administration, audit, collection, and distribution of property taxes could be reduced in counties choosing to adopt PRIT.

Explanation of Local Revenues: *General Overview:* This bill establishes a new local option income tax that can be used to replace property taxes for local units with the exception of schools and solid waste management districts. The tax would be on individual adjusted gross income tax for county residents and non-residents working in the county who do not pay a similar tax in their county of residence. The tax may be imposed, increased, and reduced in increments of .1%. The maximum tax rate for county residents is 1%. The non-resident rate is limited to .3% and can never exceed the resident tax rate. The PRIT tax may be adopted and adjusted independently of all other local income taxes (CAGIT, COIT, CEDIT). There is no maximum combined rate when PRIT and other local income taxes are assessed by the same county. Revenues collected from PRIT may be used to replace property taxes or to increase the homestead credit against property tax liability for resident homeowners.

1. PRIT for Property Tax Replacement: PRIT revenues, under this bill, may be distributed, budgeted, and used in the same manner as property taxes. If all counties adopted PRIT at the full 1%, revenues for CY99 would equal approximately \$1.042B. Using a 4% inflation rate for income taxes, revenues for CY2000 would be \$1.087B and would be \$1.133B for CY2001 (these figures will be updated when the December 1998 State Revenue Forecast is made available).

The amount of PRIT collected and used to replace local property taxes will impact distributions from the State Property Tax Replacement Fund. Under current law, counties receive state property tax replacement credits (SPTRC) equal to 20% of their gross property tax liability with certain exceptions. As PRIT revenues increase, the county's gross property tax liability will decrease and with it, the SPTRC funds received from the state.

In order to compensate PRIT counties for the reductions in their SPTRC, this bill requires the state to make a contribution to the adopting counties equal to 20% of PRIT revenues used to replace property taxes. In theory, counties with a mix of PRIT and property taxes would receive the same amount of state support as they do currently, but it would be a mix of PTRC and the additional distribution. However, due to certain exceptions the SPTRC rate is less than the full 20% (approx 13.86% in FY98). As a result, adopting counties would actually receive more money from the state than those counties that did not adopt PRIT.

There are several differences between SPTRC and the additional distribution under PRIT. First, SPTRC replaces and therefore reduces local property taxes. The state contribution equal to 20% of PRIT revenues does not replace any local taxes but is additional revenue to the county. Second, the statutory use of these two state disbursements is different. SPTRC, like property taxes, goes directly into the operating budgets of the county and its subdivisions. The new revenue from the state equal to 20% of PRIT revenues must be used for local road and highway expenditures.

2. PRIT for Homestead Tax Credits: Under this bill, PRIT may also be used to increase the homestead tax credit. The homestead tax credit is a credit against the property tax liability of resident homeowners. A portion of the credit is provided by the state. The other is provided by counties that have adopted a county option income tax (COIT). Under current law, for 1998 to 2001 the state credits homeowners 10% of their property tax liability. Counties may increase this rate by a maximum of 8% including both the state and county portion. It gives no limitations on how much the credit may be increased using PRIT.

Projected Impacts: The exact impact of PRIT will depend on whether it is used to:

- 1) replace property taxes collected for the civil units within the county,
- 2) increase the homestead credit for county resident homeowners, or

3) do both simultaneously.

The impact will also depend on the PRIT rate that is adopted by the county and how much of the county's property taxes are replaced. Three scenarios have been run to illustrate the possible impacts of this bill. They are as follows:

These scenarios are examples, and are to be used only for illustrative purposes.

1. PRIT is used to replace property taxes: For this example, assume that a county's gross property tax levy is \$1 M. Under the current law, approximately 14% of this levy would be paid by the state as SPTRC, leaving 86% to be paid by property tax revenues (see explanation above). If PRIT is used to replace \$500,000 of the property taxes, the gross property tax levy will be only \$500,000. The SPTRC would be reduced because it only equals 14% of \$500,000 rather than the full \$1M. Together revenues will equal 50% PRIT, 7% SPTRC (14% of 500,000 equals 7% of \$1M), and 43% Property taxes. In addition to these revenues, the county would also receive the additional state distribution equal to 20% of the PRIT used for property tax replacement. The following table shows this impact:

Revenue Sources	Before PRIT		With PRIT	
Property Taxes	\$860,000	86%	\$430,000	43%
State Property Tax Replacement Credits	140,000	14%	70,000	7%
PRIT used for property tax replacement			500,000	50%
Total	1,000,000	100%	1,000,000	100%
State Additional Distribution(20% PRIT)			100,000	Add
Total with PRIT	1,000,000		1,100,000	110%

Therefore, under this scenario, the county would collect \$100,000 more in revenue under this bill than they would under the current law. The state would also distribute more funds to an adopting county than under the current law (\$170,000 versus \$150,000).

Under this scenario, property taxpayers in the county will pay lower property taxes. The current homestead credit would stay the same. Income earners may experience an overall increase in tax liability if their income exceeds the value of their property. Businesses would benefit from a reduction in their property taxes and would not be subject to PRIT.

2. All of PRIT is used to increase the homestead tax credit: If all the revenue collected through PRIT is used to increase the homestead tax credit to homeowners, county revenues would remain the same. The county will not receive the additional state distribution on PRIT since none of the revenues were used to replace property taxes. The sole beneficiary of this scenario would be the county homeowners who would receive more homestead credits and thus pay less in property taxes.

3. PRIT funds are used for both property tax replacement and the homestead credit: PRIT may also

be used for both property tax replacement and the homestead credit. Under this scenario, the county would receive the additional state funding equal to 20% of the PRIT used to replace property taxes. Overall, the state's contribution to the county would increase slightly as discussed above. All of the county's property taxpayers would realize a reduction in their tax liability from the PRIT property tax replacement. Homeowners would accrue additional benefits from the increase in the homestead credit.

State Agencies Affected: Department of Revenue, State Board of Tax Commissioners, State Budget Office, Auditor of the State, Treasurer of the State.

Local Agencies Affected: Adopting Counties.

Information Sources: State Budget Agency, State Revenue Forecast.